In re Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket No. 01-338

Ex Parte Comments

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Franklin Square Communications, Inc. ("Franklin Square") is a competitive local exchange carrier whose primary business purpose is to provide local voice service through leasing the local incumbent carrier's network and utilizing the unbundled network elements – platform ("UNE-P"), and to bundle the local service with long distance service on a resale basis. As a privately-funded, start-up CLEC in central Illinois, Franklin Square wishes to express its extreme disappointment to the Federal Communications Commission ("FCC") over its reported draft decision in its Triennial Review proceeding that would change many of the key rules governing UNE-P. Franklin Square strongly believes that it would be premature and dangerous to alter the current regulatory structure and rules governing the provision of the unbundled network elements – platform, or UNE-P. Illinois and many other states have expended significant effort and resources to facilitate the development of competitive telecommunications markets, and UNE-P is a key factor to facilitating local telecom competition. Any major modifications to or de-listing of any key UNE-P elements at this important stage of this evolving process would severely impede competition, likely lead to additional litigation, and put companies like Franklin Square out of business after they have undertaken the difficult tasks associated with a start-up CLEC, including raising initial equity capital, in good faith reliance on the availability of UNE-P beyond the few months it has been practically available. The FCC has no doubt heard about the difficulties CLECs are experiencing in raising capital and executing business plans based on the UNE-P model. We wish to emphasize that these are very real problems that are currently plaguing Franklin Square.

Congress prescribed three paths in the Telecommunications Act of ("1996 Act"), Pub. L. No. 104-104, 110 Stat. 56, codified at 47 U.S.C. §§ 151-276, for competitors entering local telephone markets --- the construction of new networks, the use of unbundled elements of the incumbent's network, and resale. Franklin Square plans to utilize the provisions of the 1996 Act that allow market entry through leasing elements of the incumbents' networks at cost-based rates, *id*. § 251(c)(3). Even though the FCC required incumbents to provide UNE-P to competitors shortly after the 1996 Act was passed, protracted incumbent-initiated litigation prevented UNE-P from becoming a true path of entry until 2002. In fact, during the summer of 2001, the Illinois legislature re-wrote its telecommunication law to clear up the legal uncertainties pertaining to UNE-P in the State of Illinois. 220 ILCS ch. 5, §§ 100 – 1300.

After more than six years of litigation, incumbents have only been required for less than a year under federal law and for just over a year under Illinois law to provide UNE-P to requesting carriers. As a result, Illinois is finally experiencing unbundled network element combinations being made available to requesting carriers on a non-discriminatory basis. To illustrate, SBC was not supplying UNE-P to any Illinois carrier in September 2000, was supplying 190,000 UNE-P lines to requesting Illinois carriers in September 2001, 335,000 UNE-P lines in February 2002, and 424,000 UNE-P lines as of June 2002. In that SBC is currently serving over six million retail lines in Illinois, the number that have switched to UNE-P remains relatively small. Because competing carriers have only recently been afforded the opportunity to use unbundled network element combinations, it is premature to conclude that these strategies may not advance the long-term pro-competitive goals of the 1996 Act.

Many of the arguments supporting the elimination of UNE-P rules and regulations center on the prices that incumbents are permitted to charge for the provision of network elements, which the incumbents allege are below cost. The current rules and regulations require incumbents to use Total Element Long Run Incremental Cost ("TELRIC") based pricing, a methodology which the FCC has prescribed, 47 CFR § 51.505, and consequently, the Illinois Commerce Commission has implemented as just and reasonable rates for UNEs and which the United States Supreme Court has affirmed as appropriate. See *Verizon Communications Inc. v. FCC*, 122 S. Ct. 1646 (2002). The *Verizon* Court upheld the TELRIC standard based on the 1996 Act's objective to "jump-start" local competition by granting "aspiring competitors every possible incentive to enter local retail telephone markets, short of confiscating the incumbents' property." *Id*. at 1661.

Previously, the Court in *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366 (1999) ("*IUB*") upheld the FCC rules allowing new competitors to lease all of the incumbent's network elements, *id*. at 392-93, although it vacated the rules that defined the particular elements that the incumbents must make available on a single narrow ground: that the FCC had made the impairment findings too broadly, without considering whether new entrants could economically provide service by obtaining alternatives to network elements from providers or sources other than the incumbent, and because of the FCC's presumption that minor differences in cost or quality by itself would constitute impairment. *IUB*, 525 U.S. at 389-90. Importantly, the *IUB* Court stated that nothing in the 1996 Act prevented the FCC from requiring incumbents to make available all of their network elements and allowing competitors to provide retail service by leasing all elements and providing only the remaining retail functions. *Id*. at 392-93. The FCC responded to the *IUB* remand by promulgating the Third Report and Order and Fourth Further Notice of Proposed Rulemaking, *In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, 15 F.C.C.R. 3696 (1999) ("*UNE Remand Order*"). The FCC "beefed up" its definition of "impair" in order to comply with the *IUB* Court's directive. In May 2002, the D.C. Circuit Court of Appeals remanded the *UNE Remand Order* to the FCC for further consideration. *United States Telecom Ass'n v. FCC*, 290 F.3d 415 (D.C.Cir. 2002). The *USTA* Court determined that the FCC had not performed a sufficient "granular" assessment of competitive factors pertaining to competitive carriers' availability of alternatives to incumbent network elements. The competitive carriers - WorldCom, Inc., AT&T Corp., and Covad Communications Company - timely filed a Petition for a Writ of Certiorari, which is pending before the Supreme Court as Case No. 02-858. Franklin Square believes considerable doubt about the correctness of the *USTA* decision exists due to the Supreme Court's decision and supporting reasoning in *Verizon,* decided May 13, 2002, which opinion likely was not available to the *USTA* Court when it reported its decision on May 24, 2002. Franklin Square believes that if the USTA Court had the *Verizon* decision available to it when it was considering its decision, the Court would have reached a different result and upheld the FCC's *UNE Remand Order*. The Supreme Court in *Verizon* pointed out that Congress had found in the 1996 Act a need to "reorganize markets" by requiring regulated monopolies to grant access to their networks to new entrants who may own none of their own facilities. *Verizon,* 122 S. Ct. at 1661. Contrary to the position taken by incumbent carriers, it was not Congress' primary goal in enacting the 1996 Act to foster facilities-based market entry by competing carriers. In any event, the *USTA* decision provides the FCC adequate authority to make the findings necessary, preferably with the assistance of the various state telecommunications regulatory bodies, to reaffirm and uphold its *UNE Remand Order*.

The *USTA* remand order coincides with the FCC's "Triennial Review" of its unbundling policies. *See In re Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 16 F.C.C.R. 22781 (2001). Franklin Square agrees with and supports the contentions of other competitive carriers and state regulatory bodies that, although the *USTA* decision requires additional evidentiary support for the FCC's findings, such additional required support presents no impediment to the continuation of the existing national list of network elements and to the elimination of restrictions that have proven to impair competitive carriers in provisioning local services.

In order for the FCC Commissioners to understand the effect of the delays and uncertainties surrounding this issue, we wish to describe further a real world example. Franklin Square started business in mid 2002 with a relatively modest amount of seed capital from a few local investors. The small founding management team, among other things, had carefully developed a business plan and financial model, applied for and received certification with the Illinois Commerce Commission, negotiated contracts with key back-office, or OSS, systems providers, and negotiated an interconnection agreement with SBC, all while working out of a small amount of office space, which the Company sub-leased on a month-to-month basis. While financial resources were meager, the vision and plans were not. Franklin Square's vision is to become a regional telecom services provider in the Midwest, with a focus on smaller telecom users who would welcome a more local presence and approach, with local community involvement and cooperative marketing approaches with local organizations. Franklin Square has successfully attracted subscriptions for approximately 2/3 of the next phase of equity capital needed to move forward. But the delay and uncertainty attendant to the triennial review outcome have stopped the Company dead in its tracks: existing equity subscribers, all local individuals, are anxious about the regulatory situation, and additional new subscribers that are needed to fill out the offering are very hesitant to commit until the regulatory cloud is lifted. In hopes the FCC will permit the platform to continue and prove itself as an effective and reasonable enabling factor to facilitate competition for local service, especially for smaller competitors, management has persevered with the support of the Company's Board and investors. It seems to us that Franklin Square is the very kind of company and competitor the government should be encouraging to emerge and participate in this industry.

We understand that UNE-P should not last forever, but we believe it is bad public policy to spend so much time, money and other resources to first enact federal legislation to enable UNE-P, have the FCC, state legislatures and state regulators, along with the federal and state judiciaries, take six years to clarify the myriad details, and then after all that to reverse course and undo all what has been done prior to giving the new structure a chance to work. It seems to us to be a terrible hardship and waste to go in such a direction. Years of litigation have slowed the development of competition in our country's local phone markets. The incumbents have repeatedly challenged the implementation of the 1996 Act by the FCC and state legislators and regulators in an effort to protect their local phone service monopolies. This is probably understandable. Pain on the part of the monopoly incumbents was inevitable. That does not, however, mean that UNE-P is a bad thing. Overall, for society as a whole, it may very well be a good thing. But we will never know for sure unless upstarts like Franklin Square are allowed to utilize UNE-P as a delivery platform for a sufficient period of time to compete for customers and bring additional benefits to them. This is not just a game of charging less for the same service. Franklin Square plans, among other things, to simplify pricing and billing, to structure service packages, including features, in new and innovative ways, and to provide attentive, responsive customer service by answering the phone when customers call and promptly answering questions and resolving issues and problems. Furthermore, it seems patently unfair for the government to reverse course on local competition rules while allowing the incumbent local providers to begin offering long distance service in their home markets. This a classic example of the incumbents "having their cake and eating it too."

Franklin Square takes issue with the notion that, if UNE-P as a service delivery platform is terminated, additional investment in facilities will be forthcoming both on the part of competitive carriers and the incumbents. We have seen, prior to the availability of UNE-P, innumerable examples of companies that made such investments fail. Based on the experience Franklin Square has had in raising capital, access to capital for carriers with facilities investment in their business plans has become nonexistent. Furthermore, we do not understand what incentives the incumbents would have to increase investment following the end of UNE-P. Only if an incumbent can include additional investment in its rate base or otherwise reflect the investment in its rates will have much incentive to invest. Monopolists generally have shown little propensity to invest to achieve breakthrough or innovative results, as the risk/reward equation does not support such investments. Franklin Square also does not believe that the limited substitution of Internet-based communication, especially e-mail, and cellular phone communication for land line telephone communication is a sufficient basis for denying competitor access to incumbents' local voice networks. Such networks retain monopoly characteristics as bottleneck facilities, and are essential for carriers like Franklin Square to compete.

Commentators have speculated that the FCC may terminate or phase out, or otherwise limit, switching as a listed network element. Franklin Square is concerned that, even if other larger competitive carriers that can afford to, have installed competitive switching in Franklin Square's target markets, that may not benefit smaller competitors without switches of their own. It is not enough that there may be two or even three larger carriers, including the incumbent, with a switch in any given market area. With no duty on the part of any of such carriers to make their switch available to companies like Franklin Square, or at least make the switch available at an economical price, smaller competitors could be effectively shut out of the market. Again, this would appear to be bad public policy.

Incumbents may continue to enjoy their monopoly stronghold over their local networks even in the face of continued requirements that they lease such networks to competitors. This result would stem from wholesale lease rates that are sufficiently high that competitors cannot afford to pay them and charge retail prices that are competitive, even with incumbent retail rates. The TELRIC rate structure, which the states are obligated to follow, remains a critical component of the overall regulatory scheme. Incumbents are engaging in at least a two-pronged attack to try to regain their monopoly status. Besides seeking a rollback in their network unbundling obligations, they are seeking at the state level to increase significantly their UNE wholesale rates. In Illinois, for example, SBC filed a substantial rate increase request with the Illinois Commerce Commission ("ICC") in September 2002. Following an outpouring of criticism, SBC withdrew the rate increase proposal in October. Then, on December 24, 2002, SBC again filed a UNE rate increase request, again substantially increasing rate levels for competitive carriers. In an initial report following a review of SBC's newly proposed rates, the Telecommunications Division Staff of the ICC noted that rates for basic loop elements would increase by well over 100%, and one loop element non-recurring charge would increase by more than 1,000%. The Staff report also pointed out that, if allowed to become effective, under most circumstances UNE rates as proposed will actually be higher than the corresponding retail rates SBC charges its end users. SBC's Illinois UNE rate filing, ICC Docket 02-0864, and the Staff report can be viewed electronically at the ICC Web site – www. icc.state.il.us. Consequently, it is evident that in order to preserve UNE-P as an effective service delivery platform for competitive local carriers, regulators must both preserve the unbundling obligations and keep rates at reasonable TELRIC-based levels.

A number of potentially significant provisions of the 1996 Act have only recently been implemented. While no one can accurately predict the effect that such implementation will have, the financial performance of incumbents will likely decline from past periods when these firms dominated their markets. Such a result is a natural by-product of competitive forces. It happens in nearly every industry that is forced to dismantle or make available to competitors a portion of their delivery system or other assets that were formerly shielded by the government. The electricity and natural gas utility industries are other recent examples of monopolies that have been forced to make portions of their delivery "networks" available to competitive suppliers. While the recent electricity industry issues may invite criticism of retail energy competition, those who are knowledgeable of the industry realize that the problems have been caused by certain flawed details in the restructuring process, mainly affecting the wholesale supply and transmission of power, rather than fundamental problems with competition. Another example, closer to home, is the introduction of competition in long distance service and the break-up of AT&T. In that instance, congressional leaders, along with regulators, had the patience and vision to allow market forces to work and, as a result, the price of long-distance has plummeted. The big winners were long-distance consumers.

Movement from a protected monopoly to a competitive environment necessarily correlates with considerable pain, stress and financial and service problems during the transition period. The incentives, many of which stem from the risk/reward equation that apply to a monopolist are different than those applicable to competitive providers. Monopolists are guided by different economic and business drivers and require a certain period of time to adjust to the new drivers that restructuring and the introduction of competition necessarily bring. Their corporate cultures, formed and ingrained over many years in a monopoly environment, cannot change overnight, but change they must if the former monopolist is to survive.

Financial markets and investors loathe uncertainty. Companies like Franklin Square cannot hope to raise capital in the face of frequent regulatory rules changes. Just as Illinois and the nation are on the brink of learning whether and how unbundling strategies can effectively bring the benefits of competition to consumers in the local retail telecommunications market, the threat that the FCC will pull the rug out has halted new competitive entry into local exchange markets, at least for smaller companies. Arguments for abandoning efforts to determine how UNE-P will benefit society are not compelling --- particularly when entry strategies making use of unbundled elements of the incumbent's network are only now becoming a viable option of competitive entry. We strongly urge the FCC to reject attempts to change the current regulatory regime, to undertake the analysis and take the steps required to comply with the *USTA* Court's directives while preserving the essential components of its *UNE Remand Order*, and to allow true UNE-P competition to work, at least until its next triennial review.